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**Fitch Rates Frederick County, Maryland's GOs 'AAA'; Outlook Stable** Ratings

Endorsement Policy  
08 Jul 2014 10:32 AM (EDT)

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Fitch Ratings-New York-08 July 2014: Fitch Ratings assigns an 'AAA' rating to the following Frederick County, Maryland (the county) general obligation (GO) bonds:

--\$34.8 million general obligation public facilities bonds, series 2014A.

The bonds will be sold competitively on July 10. Proceeds will provide funds for county, school and utility capital projects.

In addition, Fitch affirms the following ratings:

--\$574.5 million GO bonds at 'AAA'.

The Rating Outlook is Stable.

#### SECURITY

The bonds are general obligations of the county, secured by its full faith and credit and unlimited taxing power.

#### KEY RATING DRIVERS

**SATISFACTORY FINANCIAL RESERVES:** Reserves considered available for operations by Fitch have historically been sound, providing satisfactory financial cushion to accommodate unforeseen spending needs or negative revenue variances.

**SOUND BUDGETARY PERFORMANCE:** Operating results are generally positive with net draws on fund balance occurring during fiscal years 2013-2014 largely related to capital and other non-recurring uses. General fund expenditures are conservatively forecasted, contributing to net results that consistently and comfortably exceed budget projections.

**ADEQUATE REVENUE FLEXIBILITY:** Revenue raising flexibility is adequate, as the county maintains a comparable property tax rate and an income tax rate that is below the state maximum.

**STRONG ECONOMIC CHARACTERISTICS:** Frederick County benefits from its location within an approximately one-hour driving distance to both the Baltimore, MD and Washington D.C. metro areas. Key economic and demographic factors, including employment and population growth, wealth indicators, educational attainment, and rates of joblessness, consistently perform at a level on par with or in excess of the state and nation.

**DEBT TO REMAIN AFFORDABLE:** Outstanding debt is rapidly amortized, affording flexibility to absorb future issuance plans with minimal impact on key debt ratios and spending levels that are currently considered moderate on an overall basis by Fitch. Post-retirement benefits are well funded.

#### RATING SENSITIVITIES

**BALANCED OPERATIONS:** The rating is sensitive to shifts in fundamental credit characteristics, including the county's ability to restore balanced operations over the near term. A material change in the county's financial flexibility and reserves relative to historical levels could pressure the current rating and/or outlook.

#### CREDIT PROFILE

Frederick County is located in the north central part of Maryland and is 664 square miles in area. The estimated 2013 population is 241,409.

#### HEALTHY RESERVE LEVELS

The county's reserve levels and financial flexibility are healthy. Fiscal 2013 ended with an operating deficit after transfers of \$6.2 million; however, results include \$8.8 million of discretionary capital spending. The unrestricted fund balance equaled \$89.9 million or a healthy 18.2% of general fund spending. The county's adequate reserve policy requires a committed general fund balance equal to 5% of general expenditures and transfers to the Board of Education and Frederick Community College on a budgetary basis was fully funded at fiscal year-end 2013. The county has established a bond rating enhancement reserve that is to be funded at 3% of budgeted general fund spending over time.

Fitch views the county's margin under the state income tax rate cap and a regionally competitive property tax rate as important measures of financial flexibility given the combined dominance (83%) of the general fund revenue base.

The 2014 budget appropriated \$36.6 million (7.1% of spending) of fund balance. According to county code provisions, the county must appropriate the prior year's entire surplus toward the following year's budget. Due to vacancy savings and conservatively budgeted property tax revenues the county projects it will spend approximately \$20.45 million of reserves on the year. The projected use of fund balance is driven by one-time capital expenses totaling \$13 million, a prudent \$1 million in additional pension contribution above the ARC, \$500,000 toward the bond rating enhancement reserve, \$1.9 million for the volunteer retirement incentive, \$2.25 million for extra snow removal costs and pothole repairs due to severe winter weather, and an additional \$1.4 million to the county's nursing home facility. The unrestricted balance is projected to decline to \$69.5 million or a still healthy 13.5% of spending.

The fiscal 2015 budget includes a 1.8% increase over the fiscal 2014 budget. The budget keeps the tax rate stable and includes a \$24.3 million fund balance appropriation. The budget funds \$7 million in merit and cost of living increases for employees, \$14.08 million in capital spending and \$6.2 million to Aurora Holdings VII, LLC for a continued care commitment for the cost of providing ongoing care to certain residents of Montevue Home following the sale of the facility to the corporation.

The county currently owns a 170-bed comprehensive and skilled nursing care facility and a 75-bed assisted living facility, Citizens Care & Rehabilitation Center and Montevue Home. Historically the facility has run losses with support required from the general fund (\$4.2 million in fiscal 2013). As such, the county turned operations over to Aurora Holdings VII, LLC beginning May 2014. Aside from the continuing care commitment that totals \$10.7 million through 2017, the county will not be obligated to provide any additional support to either facility. The county will receive \$1.44 million in lease payments annually until the sale to Aurora is finalized.

Multiyear projections show use of fund balance due to the state requirement to appropriate reserves above the 5% reserve for operations; however, historically actual results have been better than budget. Fitch believes any sustained fiscal imbalance would be inconsistent with the current rating level and could warrant a negative rating action.

#### STRONG ECONOMIC FUNDAMENTALS

Frederick County remains among the fastest growing counties in Maryland, supported by the availability of developable land, competitively priced housing stock, and reasonable proximity (approximate one-hour drive time) to three international airports, as well as employment opportunities in the Baltimore and Washington, D.C. metro areas.

With a well-educated workforce and close proximity to vibrant labor markets, the county has maintained low unemployment rates and high wealth indicators. As of April 2014, the county's unemployment rate of 4.5% was well below that of the state's 5.3% and nation's 5.9%. Median household income is approximately 114% and 157% of the state and national averages, respectively.

Fort Detrick, which is located in Frederick County, is the home of the National Cancer Institute, the U.S. Army Medical Research Institute of Infectious Diseases and the leading medical research laboratory for the nation's biological defense program. The Fort Detrick campus, which hosts five cabinet-level agencies, is responsible for over 12,000 existing employees (7,700 civilian). Despite the presence of Fort Detrick, according to census data approximately 8% of residents are employed as civilian federal employees.

The presence of Fort Detrick has fueled growth in the bioscience and advanced technology sectors, although, the county has experienced economic growth in other sectors including financial activities, education and health services and leisure hospitality. Other large private sector employers within the county include Frederick Memorial Healthcare System (2,696 employees), Wells Fargo Home Mortgage (1,881 employees) and Science Applications International Corporation (SAIC)

(1,874).

#### MANAGEABLE DEBT PROFILE

Overall debt levels are moderate at \$2,500 per capita and 2.3% of market value, excluding utility debt. Water and sewer operations provide less than sum sufficient debt service coverage, however, cash balances are over \$67 million or over 1.9 times annual operating costs. During fiscal 2014 operating revenues (excluding capital contributions) provided 0.38 times coverage of operations and debt service. The general fund does not provide any operational support for the water and sewer utility. The county implemented rate increases effective July 2013 that management anticipates will lead to self-support of utility operations including debt service by fiscal 2019. Failure to demonstrate self-support will result in Fitch's inclusion of the utility debt to the county's debt profile. The debt burden would grow to a still moderate 2.8%. Amortization of tax-supported debt is above average with over 65% of principal retired within 10 years.

Fitch expects the county's debt burden to remain manageable. The county has adopted a fiscal 2015 - 2020 capital improvement plan (CIP) totaling \$594 million. The county's education system remains the emphasis of the CIP, accounting for \$281.5 million. The planned annual amount of debt to be issued exceeds the annual amount of debt amortized; however the debt burden is projected to remain moderate at about 3%.

#### WELL-FUNDED LIABILITIES RELATED TO EMPLOYMENT BENEFITS

Long-term liabilities related to employment benefits are not expected to pressure future operations. The county provides pension benefits to its employees through a single-employer defined benefit plan and annually contributes 100% of the annual required contribution (ARC). As of July 1, 2013, the plan was well funded at 85%, or 81%, using Fitch's more conservative 7% discount rate. Due to recent plan changes and additional funding above the ARC, the county expects the funded ratio to reach 97% by 2017. The aggregate unfunded actuarial accrued liability (UAAL) totaled \$82 million or a very low 0.32% of market value.

The county also provides other post-employment benefits (OPEB) to its retirees. The county continues to provide funding over the OPEB ARC. The fiscal 2015 budget includes funding of 101% of the ARC. According to the latest actuarial valuation the funded ratio will be 54.3% as of July 2014. Fitch views this level of OPEB pre-funding a strength. The UAAL associated with OPEB totals \$112 million as of July 2013 or 0.4% of market value. Carrying costs for debt service, pension and OPEB totaled a moderate 17.2% of fiscal 2013 governmental fund spending.

#### Contact:

Primary Analyst  
Evette Caze  
Director  
+1-212-908-0376  
Fitch Ratings, Inc.  
33 Whitehall St.  
New York NY 10004

Secondary Analyst  
Michael Rinaldi  
Senior Director  
+1-212-908-0833

Committee Chairperson  
Douglas Offerman  
Senior Director  
+1-212-908-0889

Media Relations: Elizabeth Fogerty, New York, Tel: +1 (212) 908 0526, Email: [elizabeth.fogerty@fitchratings.com](mailto:elizabeth.fogerty@fitchratings.com).

Additional information is available at '[www.fitchratings.com](http://www.fitchratings.com)'.

In addition to the sources of information identified in Fitch's Tax-Supported Rating Criteria, this action was additionally informed by information from Creditscope, University Financial Associates, S&P/Case-Shiller Home Price Index, IHS Global Insight, National Association of Realtors, Fort Detrick Alliance, Real Estate Business Intelligence, Maryland

Department of Planning.

Applicable Criteria and Related Research:

--'Tax-Supported Rating Criteria' (Aug. 14, 2012);

--'U.S. Local Government Tax-Supported Rating Criteria' (Aug. 14, 2012).

**Applicable Criteria and Related Research:**

Tax-Supported Rating Criteria

U.S. Local Government Tax-Supported Rating Criteria

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**Rating Action: Moody's assigns Aa1 to Frederick County, MD's \$34.8M GO Bonds, Series 2014A; outlook stable**

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Global Credit Research - 07 Jul 2014

**Affirms Aa1 on \$482M of outstanding parity debt**

New York, July 07, 2014 --

Moody's Rating

Issue: General Obligation Public Facilities Bonds, Series 2014A; Rating: Aa1; Sale Amount: \$34,795,000; Expected Sale Date: 07-15-2014; Rating Description: General Obligation

Opinion

Moody's Investors Service has assigned a Aa1 rating to Frederick County's (MD) \$34.8 million General Obligation Public Facilities Bonds, Series 2014A. Concurrently, Moody's has affirmed the Aa1 rating on the county's \$482 million outstanding general obligation bonds. The outlook is stable. The bonds are secured by the county's absolute and unconditional ad valorem tax pledge. Proceeds of Series 2014A bonds will fund various capital projects.

SUMMARY RATINGS RATIONALE

The Aa1 rating reflects the county's sizable and diverse tax base, sound reserve position, given management's adherence to comprehensive financial policies and commitment to maintaining structurally balanced operations. Additionally, the rating incorporates the county's manageable debt position.

The stable outlook reflects the county's currently adequate reserve position, despite a decline in fiscal 2013 and a projected decline in fiscal 2014. The outlook also incorporates Moody's expectation that the county's tax base will remain sound and growing in the medium term. We believe that given the county's proximity to Washington, DC, it is well positioned to experience ongoing commercial and residential growth over the long-term.

STRENGTHS

- Sizable tax base that benefits from its proximity to the Metro-DC area
- Sound fund balance reserves bolstered by formal fiscal policies
- Manageable debt burden

CHALLENGES

- Reliance on economically sensitive revenues
- Recent declines in tax base
- Employment closely linked to federal government

Outlook

The stable outlook is based on Moody's expectation that the county's financial reserves will remain sound despite declines in fiscal 2013 and 2014 (projected). The outlook also factors maintenance of fiscal independence in the county's water-sewer and solid waste enterprise funds. Finally, the stable outlook considers possible federal budget cuts, their effects on Fort Detrick and the impacts on the county's economic and employment base. Despite near term cuts, we believe that the county's tax base will remain sound, bolstered by ongoing development and increases in private sector jobs.

WHAT COULD MOVE THE RATING UP:

- \*Maintenance of structurally-balanced operations by the county's General Fund and major enterprise systems
- \*Sustained expansion and diversification of the county's economic and employment base

#### WHAT COULD MOVE THE RATING DOWN:

- \*Marked declines in General Fund balance to levels marginally above the 5% policy minimum
- \*Failure of major enterprise systems to maintain full fiscal autonomy, resulting in the deterioration of fund equity and the operating subsidies
- \*Erosion of strong economic and employment trends relative to state and national norms
- \*Significant expenditure pressures related to rapid economic and development growth within county

The principal methodology used in this rating was US Local Government General Obligation Debt published in January 2014. Please see the Credit Policy page on [www.moody.com](http://www.moody.com) for a copy of this methodology.

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Lauren E Von Bargen  
Analyst  
Public Finance Group  
Moody's Investors Service, Inc.  
250 Greenwich Street  
New York, NY 10007  
U.S.A.  
JOURNALISTS: 212-553-0376  
SUBSCRIBERS: 212-553-1653

Edward Damutz  
VP - Senior Credit Officer  
Public Finance Group  
JOURNALISTS: 212-553-0376  
SUBSCRIBERS: 212-553-1653

Releasing Office:  
Moody's Investors Service, Inc.  
250 Greenwich Street  
New York, NY 10007  
U.S.A.  
JOURNALISTS: 212-553-0376

SUBSCRIBERS: 212-553-1653



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## Summary:

# Frederick County, Maryland; General Obligation

### Primary Credit Analyst:

Timothy W Barrett, New York (1) 212-438-6327; [timothy.barrett@standardandpoors.com](mailto:timothy.barrett@standardandpoors.com)

### Secondary Contact:

Lindsay Wilhelm, New York (1) 212-438-2301; [lindsay.wilhelm@standardandpoors.com](mailto:lindsay.wilhelm@standardandpoors.com)

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## Summary:

# Frederick County, Maryland; General Obligation

### Credit Profile

US\$34.795 mil GO facs bnds ser 2014A due 08/01/2034

*Long Term Rating*

AAA/Stable

New

#### **Frederick Cnty GO**

*Long Term Rating*

AAA/Stable

Upgraded

## Rationale

Standard & Poor's Ratings Services raised its rating on Frederick County, Md.'s general obligation (GO) debt one notch to 'AAA' from 'AA+' based on Standard & Poor's local GO criteria, published Sept. 12, 2013, on RatingsDirect. The outlook is stable.

At the same time, Standard & Poor's assigned its 'AAA' rating and stable outlook to the county's series 2014A GO public facilities bonds.

The county's full-faith-and-credit pledge secures the GO bonds. Officials intend to use series 2014A bond proceeds to fund various county infrastructure projects and refund the county's 2012 capital lease.

The rating reflects our opinion of the following factors for the county, specifically its:

- Very strong economy that participates in the Washington-Arlington-Alexandria metropolitan statistical area (MSA), coupled with low unemployment and strong income and wealth;
- Very strong budgetary flexibility with available reserves of more than 15% of operating expenses over the past four fiscal years;
- Weak budgetary performance over the past two fiscal years with a diverse revenue stream, led by property and income taxes that generate 52% and 40%, respectively, of general fund revenue;
- Very strong liquidity, providing very strong cash to cover debt service and expenditures;
- Very strong management conditions with "strong" financial management policies and practices under our Financial Management Assessment (FMA) methodology; and
- Adequate debt and contingent liabilities due to low carrying charges, low net debt, and rapid amortization.

### **Very strong economy**

In our opinion, Frederick County's economy is very strong. The county, in northern Maryland along the Pennsylvania border, is one of the outer-rim counties surrounding Washington. Although a large portion of the county remains rural, population growth continues at, what we consider, a healthy, but manageable, pace. The population estimate of 240,673 is a 60.2% increase from the 1990 U.S. Census and a 23.2% increase since the 2000 U.S. Census; the county's population growth far outpaced the state's population growth over the same period. We believe the county's location in the Washington-Arlington-Alexandria MSA, access to a good transportation network, and lower cost of living have contributed to strong population growth. The county contains 12 incorporated municipalities, the largest of which is

Frederick with a population estimate of 67,696.

Fort Detrick and its estimated 12,900 military and civilian personnel anchor the county's economy. Because of 2005 base realignment and closures, Fort Detrick has experienced additional capital investments and job growth, which we expect to continue. Manufacturing is also important to the county. As of 2013, 170 manufacturing establishments employed approximately 4,767.

We view unemployment as historically low despite 77% of land classified as agricultural or resource conservation (mountains, floodplains, etc). We understand management is committed to maintaining the county's significant rural land use. Unemployment averaged just 5.7% in 2013, well below the national rate. Income, slightly above the state's average and well above the nation's average, has been higher over the past two decades. Projected per capita effective buying income is 130% of the nation's level.

The large and diverse property tax base totals \$25.8 billion in fiscal 2014, or, what we view as, a strong \$107,081 per capita. The tax base has experienced slight decreases over the past two fiscal years; it has decreased by 4.2% following years of, what we consider, strong growth. Management expects assessed value (AV) to increase slightly by 1.1% for fiscal 2015 to \$26 billion. Current tax collections have historically been, in our view, strong at more than 99%. The tax base is very diverse with the 10 leading taxpayers accounting for just 2.4% of AV.

### **Very strong budget flexibility**

In our view, budget flexibility is very strong. The county benefits from, what we regard as, conservative, formal, and well-adhered-to fiscal policies that have led to the maintenance of very strong reserves. According to its fund balance policy, the county maintains 5% of general fund budgeted expenditures as committed fund balance and holds 3% in committed reserves as a bond rating enhancement. Combined committed reserves total \$25.2 million, and we understand these reserves are available for general expenditures following board approval. In addition to these reserves, the county maintains \$64.6 million of assigned and unassigned reserves. Available reserves, including committed reserves, total \$89.8 million, or, what we view as, a very strong 20.9% of general fund expenditures, at fiscal year-end 2013.

We understand that for fiscal 2014, the county expects to draw down available reserves by \$15.6 million to a total of \$74.2 million. Despite the drawdown, total available reserves should remain more than 15% of operating expenditures. In fiscal 2015, the county conservatively appropriated \$24.3 million of reserves, or \$12.2 million less than the fiscal 2014 appropriation and \$16.9 million less than the fiscal 2013 appropriation. We do not expect county officials to draw down reserves through the appropriation due to the county's history of generating sizable positive variances compared to the budget.

### **Weak budgetary performance**

In our view, overall budgetary performance has been weak over the past two fiscal years, which followed years of, what we view as, strong operating surpluses between fiscal years 2010 and 2012. For fiscal 2015, the general fund budget has increased by \$9.4 million, or less than 1% of expenditures, to \$525.7 million. Officials are appropriating roughly \$24.3 million of general fund reserves for fiscal 2015. The property tax rate for fiscal 2015 is at the constant yield rate of \$1.06 per \$100 of AV; the income tax remains unchanged at 2.96%, well below the 3.2% maximum allowed by the state. The county is, what we regard as, very conservative in its budget assumptions; it has historically



generated large positive variances compared to the budget. Therefore, we expect the county to replenish a significant portion of its appropriation.

In fiscal 2014, the county consolidated the fire and rescue tax district into the general fund, including the fire tax rate of 0.128 cents. Officials appropriated \$36.6 million of general fund reserves for fiscal 2014. Due to conservative budgeting, we understand management expects to draw down available reserves by \$15.6 million to a total of \$74.2 million, which includes a \$13.1 million transfer into the capital projects fund for pay-as-you-go capital expenditures. Despite the drawdown, available general fund reserves remained more than 15% of expenditures.

Audited fiscal 2013 results show a slight general fund drawdown of \$6.2 million, including the transfer of \$8.8 million into the capital projects fund, despite officials appropriating \$41.4 million of reserves in the budget. Management attributes the significant positive variance to property and income taxes coming in well above the budget and management-implemented cost controls that resulted in expenditure savings. The county ended fiscal 2013 with an available fund balance of \$89.8 million, or 20.9% of operating expenses.

Property taxes generate 52% of general fund revenue and income taxes generate 40%. We understand the county also benefits from revenue flexibility with these taxes. Specifically, the county has levied an income tax of 2.96% out of a 3.2% limit since 2002. In our opinion, the \$1.06 per \$100 of AV property tax rate is about average compared with the rates of other area counties.

### **Very strong liquidity**

In our view, the county maintains very strong liquidity, providing very strong cash to cover debt service and expenditures, with total available cash and unrestricted investments of 51.2% of total governmental funds expenditures and more than 5x debt service. We believe the county has strong access to external liquidity because it has issued GO debt in the past.

### **Very strong management**

We view the county's management conditions as very strong, including "strong" financial management policies under our FMA methodology, indicating practices are strong, well embedded, and likely sustainable.

### **Adequate debt and contingent liabilities profile**

We view overall net debt as adequate with a fiscal 2013 debt service of 9.9% of total governmental funds expenditures and net direct debt -- net of self-supporting GO debt paid by the county's utility funds -- of 110% of total governmental funds revenue. We consider principal debt amortization above average with officials planning to retire roughly two-thirds over 10 years. Overall net debt following this issuance equals 2.6% of market value.

We understand the county intends to issue roughly \$285 million of GO debt over the next six fiscal years, or roughly \$47.5 million annually, to help fund a \$555 million capital improvement plan. Other financing sources include \$95 million of federal and state grants and \$64.9 million of pay-as-you-go general fund transfers.

We recognize Frederick County has historically paid its annual pension cost in full. In fiscal 2013, the pension cost was \$20 million, or about 3.7% of governmental expenditures. As of July 1, 2013, we understand the retirement plan was 85.4% funded with an unfunded liability of \$59.7 million. For fiscal 2013, the county contributed 130% of the other postemployment benefits (OPEB) cost of \$18.4 million, or 3.4% of governmental expenditures. As of July 1, 2014, the

OPEB liability was 54.3% funded with a current unfunded liability of \$75.8 million. The county expects to continue to fund its OPEB annual required contribution in full.

### **Very strong Institutional Framework**

We consider the Institutional Framework score for Maryland counties very strong.

## **Outlook**

The stable outlook reflects Standard & Poor's opinion of Frederick County's large, diverse, and vibrant economy. The outlook also reflects our opinion that the county's budgetary flexibility and liquidity will likely remain strong and stable and that management will likely continue to conservatively budget for economically sensitive revenue and adjust expenses, as needed, to maintain fiscal balance. While the county's capital plan remains sizable, we believe overall debt will likely remain close to current levels due to, what we consider, the county's above-average amortization, providing additional rating stability. Therefore, we do not currently expect to change the rating within the outlook's two-year period. If the county were to experience significant drawdowns due to a fiscal imbalance, however, we could lower the rating.

## **Related Criteria And Research**

### **Related Criteria**

USPF Criteria: Local Government GO Ratings Methodology And Assumptions, Sept. 12, 2013

### **Related Research**

- S&P Public Finance Local GO Criteria: How We Adjust Data For Analytic Consistency, Sept. 12, 2013
- Institutional Framework Overview: Maryland Local Governments

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